Trans-Pacific Partnership (TPP) and East Asian Economic Integration

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Introduction:

We will talk about East Asian Economic Integration, that is, how the economies in this region are integrated. Specifically, we will want to look at the Asian-perspective of the Trans-Pacific Partnership (TPP). We have heard the U.S.'s viewpoint on TPP recently in the news, especially with the Trump administration's negative standpoint on the TPP, but in what follows we will consider it from the Asian perspective and how the TPP fits into the larger view of economic integration.

What are the Drivers Behind East Asian Economic Integration?

First of all, let us consider what are the drivers behind East Asian economic integration? There are essentially two forces: the market-led force and free trade agreements (FTAs). The market force consists of business interest to operate overseas, invest abroad, and foster "transnational production networks" (TPN); and FTAs consists of deals which aim to lower or eliminate trade barriers across economies, thus fostering economic integration.

The Market-led Force

First, considering the market-led force, business interests have created what has been dubbed "Factory Asia": the manifestation of the transnational production network, also known as the "global production network," "global supply chain," or "global value chain."

TPNs are now defined by "fragmented" supply chains, with internationally dispersed tasks and activities coordinated by a lead firm/MNCs. Goods are now more than ever produced in divided pieces, where different parts of a product are produced in different parts of the world. For instance, if you have an iPhone, its label says, "Designed by Apple in California, assembled in China." This is an example of how production networks have been used to build products. The iPhone's product design (and case) originates in California, the camera is produced in Germany, and the screen is produced in South Korea. These, and other parts are shipped to China where they are assembled together and then shipped to be sold back to the U.S. and elsewhere around the world. The iPhone is a good illustration of the concept of a "transnational production network" (TPN). But for our purposes, we should note the fragmentation of these production networks actually serve to help the integration of asian economies.

For another example of the fragmentation of production, consider the Boeing 787 Dreamliner a quintessential American product. You would think since this is from the Boeing Company, that the 787 Dreamliner is "Made in America." However, it could be described as "Made in the World."

This example demonstrates how transnational production networks are taking over in terms of producing goods and services. A specifically East Asian example includes the parts procurement of a Hard Disc drive assembler in Singapore. A Hard Drive consists of several pieces and components, which are produced in different countries and all these shipped to Singapore for final assembled.

Rise of Mega-FTAs

We see that the supply chain is fragmented across multiple countries. Therefore, we need FTAs to remove trade barriers and make TPNs work better, further integrating these economies. In fact the integration that we see today is largely a result of previous FTAs which help review trade value across countries and ease the shipping of parts and components by removing tariffs.

The World Trade Organization (WTO) pushes for liberating trade and investment. However, due to conflict of interests there was a stalemate occurring within the WTO, so that since the year 2000 many counties have turned to “regional trade packs” or “regional trade agreements” in order to liberate trade between themselves. This led to the uprise of many regional FTAs since the year 2000.

The thinking behind this was, if we cannot liberate trade among the 100+ countries inside the WTO we can still achieve some degree of free trade through GATT/WTO’s Article XXIV. If a country can form trade blocks or foster regional trade agreements, then under Article XXIV they can inform the WTO, so long as they prove that their trade block will expand over time to include more WTO members. This process is helping to build free trade in the world. As of July 2006, WTO has been notified of 635 RTAs.

There are large benefits of having many FTAs, including increased GPD across countries—if you combine countries under an FTA there is net GDP growth. The division of labor helps countries to exploit a competitive advantage. Once countries’ economies are tied together, this creates larger regional markets, which fosters the growth of economies of scale. Wider markets also increase competition among firms. A firm operating inside an FTA can come up with methods that help boost efficiency in production. And also the force of a regional FTA can help accelerate domestic reforms within each country that is party to the agreement.

The mega-FTAs in the region we will be focusing on are the TPP and the RCEP.

History and Background of the Trans-Pacific Partnership (TPP)

Recently in the news U.S. President Trump has made famous the TPP. But the TPP did not begin as the large pack we see today, rather it emerged from a P4 agreement between four counties wanting to form an FTA together in 2005: Brunei, Chile, New Zealand, and Singapore. Later when the U.S. and Japan joined in 2011 the TPP became a big news item, even though it had existed 6 years prior.

There are currently 12 members in the TPP, including: Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, and Vietnam. The primary aim is to craft “the 21st century trade deals,” to go beyond the WTO commitments for instance with labor standards, environmental protection, and property rights. The TPP is an example of a Mega-FTA. If you combine the GDP of these 12 members, the TPP would cover 40% of world GDP, or 1/3, of world exports. If the TPP comes into fruition the benefit for combined world export would be enormous.

The TPP is not only viewed as a tool to advance economic integration between counties. Sometimes the TPP is viewed a strategic tool to advance foreign policy goals. For instance, in the Obama administration the TPP is used as part of the “Rebalance” or “Pivot Towards Asia,” in order to have more engagement with the region.

There is difference, however, between western and Asian media coverage on the TPP. Specifically why China did not join the TPP is viewed differently between western and Asian countries. In the western media, TPP is often portrayed as the U.S.’s means to contain China’s economic rise. Western media says China did not join the TPP because the U.S. set it up to be against their favor. However, media within the Asian region views the TPP differently; rather than viewing the TPP as a way to contain China, Asian media tends to see China’s lack of involvement to be due to elements of the TPP that do not align with China’s interests; for example, international property rights (IPR). Right now China is not producing many IPR goods and they want to produce more. If they sign on to the agreement, then China would have to follow IPR laws and there would be restrictions upon the production of IPR goods. Such restrictions are not good for developing countries like China who are trying to produce new IPR goods and services.

Negotiations for the TPP started in 2001 and concluded in October, 2015. And the U.S. under President Trump has decided to withdraw from the TPP. We will discuss this more below.

The Regional Comprehensive Economic Partnership (RCEP)

The second mega-FTA to consider, that if completed will bring many benefits to the regional economy, is the Regional Comprehensive Economic Partnership (RCEP). RCEP’s members consist of ten ASEAN counties plus six additional counties (China, Japan, Korea, Australia, New Zealand, and India), referred to collectively as the ASEAN+6.

ASEAN itself is a group of ten small economies, which has formulated FTAs with additional larger economies, creating many ASEAN+1 FTAs (e.g., an ASEAN+Japan or ASEAN+China FTA). The problem is this has led to contradictory commitments and undermining between the various ASEAN+1 FTAs—referred to as the “Noodle Bowl” problem.

The Noodle Bowl problem was one of the instigating factors behind the creation of the RCEP. The goal of the RCEP, therefore, is to consolidate the many ASEAN+1 FTAs into a Mega-FTA, ironing out the differences between all existing ASEAN+1 FTAs so business can proceed under the same rules and regulations.

Some media portrayal of the RCEP is that it is China-led to rival the U.S.-led TPP. However, the RCEP is more accurately described as ASEAN-led. This can be seen by looking at the negotiations in process, including the guiding principle for how these negotiations are to be driven. These documents dictate RCEP negotiations must be driven by ASEAN neutrality, that the ASEAN will be the main driving force for shaping agenda and how negotiations will be conducted. So RCEP is an ASEAN-led process, not a China-led process as it has been portrayed in many medias.

RCEP as a Mega-FTA with Focus on SMEs:

The combined population of the ASEAN+6 countries covers 45% of the world’s population and 1/3 of the world’s GDP. So if it succeeds the RCEP will certainly qualify as a mega-FTA. The RCEP negotiations cover a wide range of things: trade in goods, trades in services, investment, economic and technical cooperation, intellectual property, competition, Ecommerce, legal and institutional matters, etc. The negotiations were launched in 2013 and currently remain ongoing with a goal to reach an agreement by the end of 2017.

Within the RCEP there is a focus on “small-to-medium sized enterprises” (SMEs) and how to make SMEs benefit on the final agreement. The majority of firms ran within ASEAN countries are small-to-medium sized enterprises. The number of SMEs varies from country to country. In some countries only 70% of firms are SMEs but in other ASEAN countries SMEs cover 95% of businesses. Therefore because ASEAN is within the RCEP block, they have put special emphasis on SME development, and how to make SMEs benefit from the final agreement.

President Trump’s Economic Policies

Trump’s campaign slogans and promises included: “Make America Great Again,” “America First,” and the promise to bring back the 28 million jobs lost since the global financial crisis. Some of these promises have been translated into his policy conduct, for example, his withdraw from the TTP and threat to renegotiate or terminate the North America Free Trade Agreement (NAFTA), and his favor of bilateral (rather than multi-lateral) trade negotiations; Trump has pushed for a less active role in IMF and World Bank and moved away from liberal rules-based economic system towards isolationism and mercantilism.

Some will say Trump’s effect could be minimal due to the U.S. government’s built-in checks and balances to constrain presidential power by the congress, senate, and courts. However, if you look at the trade policy in general, the president has a lot of leeway to affect final trade outcome.

For example, the U.S. congress has delegated much power to the executive branch to conduct trade policy. The Trade Act of 1974 has sections granting the president “trade promotion authority” (sec. 151), “termination and withdrawal authority” (sec. 125), response to “unfair trade practices” including the right to create tariffs (sec. 301), “balance of payments” (sec. 122). Further the “International Emergency Economic Powers Act” (IEEPA) gives the president the power to roll out trade barriers and slap tariffs on certain counties in the event of an “economic emergency.” It is not difficult to imagine a president inciting the IEEPA, claiming NAFTA is going to incite an economic emergency to the U.S., so we will tariff (e.g.) Mexican goods. Executive orders are another means the president has to affect economic policies, including, for example, the executive order to withdraw from the TPP.

Effects of Trump’s Policies on Regional Trade

East Asian economies trade with the U.S., so this region is watching Trump’s policies closely. If America changes its trade policies, what is going to happen to our regional economy? If Trump rolls out new policies that block imports in order to boost U.S. jobs, it will affect regional exports to the U.S. But if you look at the numbers of exports from ASEAN counties to the U.S. it is only 10.9%. We can tentatively conclude that changes in the U.S.’s trade stances will reduce exports but the affect will not be as dramatic as it first appears—only affecting about 11% of total exports. ASEAN counties export more among other ASEAN countries and to China much more than to the U.S.

If Trump actually rolls out protectionist policies, the degree of economic damage will vary based on specific countries’ level of trade openness and level of export to the U.S. For example, Singapore and Vietnam will be hit the most because they export about 8% to the U.S.; on the other hand, Indonesia only has about 2% of exports going to the U.S.

What about investments? Here again the damage might not be as bad as could be expected. ASEAN only relies on the U.S. for 11.3% of the total FDI inflow into ASEAN. ASEAN economy will receive FDI from other ASEAN countries, the EU, and Japan and it relies more on these countries than the U.S. for FDI inflow. Therefore it is difficult to assess the direct damage between U.S. and ASEAN economies caused by possible isolationist policies.

Possible U.S.-China Trade Wars

Perhaps the regional Asian economy would be negatively effected by a possible trade conflict between the U.S. and China. Recently President Trump threatened to slap a 45% tariff on Chinese goods. This could draw China to retaliate with its own tariffs on U.S. products (e.g., Boeing airplanes, soybeans, or wheat). The retaliation could also come in the form of a non-tariff barrier, for instance policies requiring longer screening, more custom-clearing forms, increasing other taxes, or otherwise make life more difficult for U.S. firms.

If such a trade war ensued between two major economies, this would negatively affect Asian regional economy due to the highly integrated transnational production networks discussed above. The East Asian economy is linked to China as part of the global supply chain in that many goods are shipped to be assembled in China.

The U.S. Withdrawal from the TPP

By withdrawing from the TPP, the U.S. has lost an opportunity to take leadership in constructing regional trade governance. From an international relations viewpoint, this will affect U.S.-ASEAN relations. Many Asian countries want further U.S. engagement in this region due to tensions in the South China Sea. Security wise, we need the U.S. to establish stability in the South China Sea and the U.S.'s withdraw from the TPP could create doubts whether the U.S. will continue to be willing to engage in the region. If the U.S. does withdraw, this will increase tensions between China and other East Asian countries. In fact, some regional states may lean towards China, for example Cambodia and Laos. It remains to be seen how this will affect the association of ASEAN. Such a situation will test the solidarity and centrality of ASEAN.

What Will Post-TPP Regional Economic Integration Look Like? Four Major Trends

If the TPP fails, this will change regional states' calculations, they will have to hedge their bets by looking at other regional frameworks. Instead of relying on the U.S. to shape regional trade architecture, Asia must find a solution for itself. In that case, regional integration is likely to be shaped by the following four major trends, which we will consider now:

1. ASEAN Economic Community (AEC)
2. Regional Comprehensive Economic Partnership (RCEP)
3. TPP11
4. Free Trade area of the Asia-Pacific (FTAAP)

1. ASEAN Economic Community (AEC)

AEC is an effort by the 10 small ASEAN countries to try to integrate their economies. This concept was initiated in 2003 by ASEAN leaders, described as "a single market and production base with free flow of goods, services, investment, skilled labour and freer flow of capital." At the 12th ASEAN Summit in January 2007 the AEC creation deadline was brought forward from 2020 to 2015. At the 13th ASEAN summit in November 2007, a blueprint was adopted with action steps for integrating the economies and then it was succeeded by a 2015 version "the AEC Blueprint 2025."

This blueprint details the action steps necessary to integrate these 10 small economies by 2025. The plan distills the integration process into 5 pillars and within each pillar there are subsections and specific policy actions. The five pillars are:

> (i) a highly integrated and cohesive economy, (ii) a competitive, innovative, and dynamic ASEAN, (iii) enhanced connectivity and sectorial cooperation, (iv) a resilient, inclusive, people oriented, people-centered ASEAN, and (v) a global ASEAN.

The AEC is viewed as a process and not a destination. Its creation is seen more as a milestone along the pathway of East Asian economic regional integration. But why is the AEC essential to East Asian economic growth and development? For one, it can help foster the transnational production network inside Southeast Asia. With the rise of protectionism, the shift in U.S. trade stance, Asia needs to look for other markets—a regional one. A completed AEC can deepen existing TPNs, boost intra-ASEAN and regional trade (which has been stagnant for a decade), and, strategically, make ASEAN gain a stronger hand in other negotiations and enhance ASEAN centrality. If AEC goes through, then this will make ASEAN a larger economic entity, which will allow more leverage at trade negotiations; this is why its developers view AEC as a strategic project. The ASEAN countries want to conclude AEC negotiations in 2017 to coincide with with the 50th anniversary of ASEAN.

2. Regional Comprehensive Economic Partnership (RCEP)

The second factor that I think will shape the future of East Asian economic integration is the RCEP. With the potential failure of the TPP, the RCEP has become an immediate priority for larger regional integration. The absence of the TPP has changed the calculations of the countries whose membership overlaps TPP and RCEP: Australia, Brunei, Japan, Malaysia, New Zealand, Singapore, and Vietnam. One can see the turn towards the RCEP in the comments of Japanese Prime Minister Abe: "There's no doubt that there will be a pivot to the RCEP if the TPP doesn't go forward." Likewise, Australian Foreign Minister Julie Bishop has stated that if the TPP fails, "then the vacuum that would be created is most likely to be filled by RCEP." And the Malaysian Trade Minister Mustapa Mohamed has also indicated Malaysia will focus its efforts on the RCEP.

The reasoning behind this pivot is simple: the countries who overlapped in TPP and RCEP will now care more about the final quality of the RCEP deal, since they cannot now fall back on the TPP and trade more with the U.S. So what will the final deal probably look like? There will most likely be a push for talks about government procurements, policies to deal with SOEs and various other negotiations. But hopefully they will be able to bring forward the lessons learned in trade negotiations over the five and a half years focused on the TPP.

There are a host of challenges facing the RCEP. There are at least five FTAs whose differences must be ironed out and consolidated. Further, across the negotiating parties the members are at various economic developmental stages; so more advanced countries will want to push for a higher quality deal, but the lesser developed countries will be reluctant to do so. The RCEP is where major economies are facing for the first how to work out an FTA. For instance, China and India have no FTAs between themselves and must start the process from scratch learning how they will go about liberating trade among themselves. Lastly, another problem facing the RCEP is the lack of clear leadership in RCEP negotiations. The TPP had the U.S. and Japan, but for the RCEP who will leverage other states to come on board?

3. TPP11

There have been talks in Chile to discuss ways forward with the TPP—including a TPP without the U.S. The TPP11 would be a way to salvage the TPP without having the United States as a member. Countries such as Australia and New Zealand have already pledged to attempt to salvage the TPP apart from U.S. involvement. There are at least two difficulties moving forward, however.

First, Article 30.5 of the agreement would need to be altered. This article dictates that ratification of the TPP is required by “at least six of the original signatories, which together account for at least 85 percent of the combined gross domestic product of the original signatories in 2013.” This clause’s wording alone does not require the U.S. for ratification as only six of the original signatories. However it is a practical roadblock due to the fact that no combination of countries without the U.S. will be able to make the 85 percent GDP threshold (due to the sheer size of the U.S.’s GDP). Therefore article 30.5 will need to be changed for the TPP to go forward.

Secondly, negotiation outcomes will depend on state interests, which vary. You can break down the TPP11’s members into at least two subgroups: those that already have trade pacts with the U.S. and those without such trade pacts (who have lock-in domestic reforms). For instance, Singapore and Brunei have FTAs with the U.S. and Mexico and Canada enjoys the benefits of NAFTA, but Japan and Vietnam does not have FTAs with the U.S. The former countries may not be as enthusiastic about pushing forward TPP11 since they have other FTA options to fall back on.

4. Free Trade Area of the Asia Pacific (FTAAP)

The final area that will shape the future of trade in the region going forward is the FTAAP. This is not a new concept, nor is it a new Chinese idea (as some media outlets have erroneously reported), but was originally coined in the “Bogor Goals” in 1994 by the Asia-Pacific Economic Cooperation (APEC). The “Bogor Goals” sought to see “free and open trade and investment in the Asia-Pacific by 2010 for developed economies and 2020 for developing countries.” The idea was originally pushed by Australia and the U.S., but it was under the Chinese chairmanship in 2014 that FTAAP became a focus. A study that was launched in 2016 concluded that FTAAP “would accelerate regional economic integration as well as enhance trade and investment growth through removal of trade barriers, thus driving long-term economic development.”

From the regional perspective, the FTAAP is a long-term Asian economic goal. The immediate priority is to focus on RCEP negotiation. There is an RCEP membership issue, however, as the FTAAP is fundamentally an APEC project. Countries such as Myanmar, Cambodia, Laos, and India must first be accepted as APEC members before being included in FTAAP. Further, there may be some negotiation difficulties with APEC countries that are non-RCEP members (e.g., Canada, Chile, Hong Kong, Mexico, Papua New Guinea, Peru, Russia, Taiwan, and the U.S.). These countries may have different ideas about what should and should not be folded into the final agreement of the FTAAP. Issues such as this are why the FTAAP should be considered a long-term goal.

Conclusion

President Trump's economic policies will affect regional states' economies to varying degrees. However, there is reason to believe the direct impacts may not be huge. As mentioned above, only about ten percent of total exports go to the U.S. and only eleven percent of total FDI inflow comes from the U.S. But negative effects may come indirectly through possible trade wars or trade tensions between the U.S. and China. This is due to regional states' economies being linked to the Chinese economy via transnational trade production networks. Going forward, the factors likely to shape regional integration are the AEC, RCEP, TPP11, and FTAAP, or a combination of them.